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Barriers To CEO Succession

Why is CEO succession “the topic we don’t talk about?”

by Randall S. Cheloha, Ph.D.

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Barriers To CEO Succession

by Randall S. Cheloha, Ph.D.

CEO turnover is rising as boards struggle to deal with restructuring and potential business failures. Many boards also face their own failure to insist on a sound, workable CEO succession plan. Both chief executives and boards tend to put off hard choices on succession, but there are several effective tactics for painlessly adding future CEO change to your board's agenda.

At a large northeastern telecommunications company, we were introduced to the CEO by the vice president of human resources to aid in planning the CEO's succession. The CEO was nearing retirement age, but the company had done no formal planning for his successor.

Compounding a complex and messy situation, the CEO had been handed an ultimatum by one of his direct reports—"play me or trade me." This executive ran the most profitable division by far and was a strongly outspoken individualist (i.e., not a team player). He made his colleagues consistently uncomfortable with his blunt and non-sparing critiques.

The CEO was hamstrung. He was caught in the middle by a hard-charging executive who expected to be nominated as a CEO successor as is his due, a senior team who would never accept this executive as their boss, and a board who knew something had to be done, but were unaware of the internal dynamics. This CEO, cast from the "imperial" CEO mold, played his cards extremely close to the vest. He had not shared the specific details of his problems with his board although they were aware of some of them through back channels.

Our firm became involved in the CEO succession planning and worked with the CEO. We sought to develop a plan that was realistic given the two-year time frame, would provide a viable candidate, and would not de-stabilize the organization.

The CEO "nominated" five internal candidates (including the outspoken leader) as potential successors.

We assessed each, and provided feedback to the CEO and his VP of HR about the "best" candidate given the anticipated demands on the next CEO. Since the CEO's expected retirement date was two years out, there was still sufficient time for each candidate to be developed further.

However, the situation did not work out as planned, nor is there a happy ending. Since the CEO had not included the board in the succession planning process until the outspoken executive forced his hand, directors did not feel engaged in the process. The outspoken executive took himself out of the running by leaving for a "better" offer.

In the end, the CEO resigned and the board was forced to make a choice—insider or outsider. They decided fresh talent was needed and recruited an outside CEO from a competitor. Shortly thereafter, the most profitable division (the one headed by the outspoken executive) imploded, and the company's market cap dropped precipitously. Could this entire drama have been avoided?

Approximately 50 percent of major companies lack a *realistic*, strategic plan for replacing their CEO.

As a long-time management consultant working with and for CEOs, senior executives, and directors on succession issues, I have been struck by how many major companies lack a realistic plan for replacing their CEO. Approximately 50 percent do not, according to a Mercer Delta study.

That is not to say a plan does not exist. Most boards take their fiduciary responsibility seriously and have in place both a short- and long-term CEO succession plan which names a specific person to ensure continuity of leadership. However, many boards

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treat this responsibility as a reporting requirement rather than a strategic commitment to the integrity and viability of the company, plus an opportunity to build the next generation of leadership.

Instead, they choose someone who reports directly to the CEO, who has shown promise, and has the CEOs' blessing. However, knowing the actual decision may not be made for several years, the board fails to view signing off on this document nearly as seriously as some other responsibilities.

The business media report an increasing number of spectacular CEO failures at Fortune 500s over the past year, with the companies having no ready replacement. Something somewhere is missing in planning for succession. Why?

We can rule out the purely logical reasons why boards do not prepare. The actual processes and tools for designing, developing, and implementing a CEO succession have been widely available for over 30 years. The "how to" information resides in the public domain and is not closely guarded competitive information. It is not a question of knowing what to do.

Instead of discussing traditional business problems, where there are differing views on strategy, marketing plans, and market share, we are dealing with people's feelings, hopes, and dreams. There is a pattern of several significant emotional obstacles to CEO succession that ultimately slow, block, and undermine the best laid plans:

□ *CEO denial and resistance.* CEOs avoid planning for their succession. On receiving the new job, they want to savor their achievement while looking forward to years of untrammelled success and putting their imprint on the organization. Discussing succession makes CEOs uncomfortable and anxious. It points out their vulnerability and the reality that they, too, are mortal and replaceable.

CEOs are human and deal with the same range of emotions as anyone else facing retirement. The idea of being replaced, not being in charge, and becoming obsolete makes us all uncomfortable. Added factors are the power of the position, the number of people affected, the financial reverberations, and the degree to which most CEOs define their identity with the

company. All of these make a challenging issue far more difficult. For directors, which are ultimately social beings, it is easier not to confront the issue.

Directors are no more comfortable with confrontation than anyone else, and do not like to confront their CEO on matters like succession.

□ *Board avoidance and inertia.* Enough has been written on succession over the last ten years to suggest it is the rare board that does not understand its responsibility in planning for CEO succession. However, boards are composed of people. They are other leaders who function as a group, ideally as a team, but ultimately are susceptible to the same unspoken human relationships that influence us all.

Directors are no more comfortable with confrontation than anyone else, and do not like to confront their CEO about most matters including succession. Many were appointed by this CEO and feel a debt of loyalty. Even those who precede the CEO by many years on the board may have been through an unsuccessful CEO succession in the past.

These prior experiences only serve to reinforce the idea of not raising uncomfortable issues or treading on emotional ground. Directors surely do not want to pressure, either directly or indirectly, a new CEO with whom they are building a working relationship.

Worse, when things are going well and the company is operating profitably and Wall Street is happy, most boards are reluctant to address the "moose on the table" of CEO succession. Why fix what is not broken? So, boards dodge their responsibility. Consciously and unconsciously, they collude with the CEO to put off discussions about succession planning.

□ *The inherent risk in judging future CEO potential.* Judging human potential and predicting future behavior is fraught with risk since ultimately no one ever gets it right all the time. Many company's deal with this risk and uncertainty by going to the outside and choosing a known entity. This may be

a former CEO with a track record, even one from a different industry or under entirely different strategic/market circumstances. It is almost as if the boards believe, “once a successful CEO, always a successful CEO.”

Search firms encourage this thinking. As with college and major league sports, it seems that very few new head coaches are ever created. Instead, the same talent is recycled from job to job, independent of their success. Yet, research has consistently demonstrated that outside CEOs have a much higher failure rate (about a three to one ratio according to a recent study), suggesting greater emphasis should be placed on developing an insider.

On the other hand, selecting and grooming an internal successor opens a Pandora’s box of sticky issues. What do we do with executives who had CEO aspirations and were not selected? Will they leave and create a leadership vacuum (while taking their loyal lieutenants with them)? How do we keep them motivated in their current assignment? What happens if the entire senior team resigns en masse, frustrated with being passed over?

The board faces a host of tricky issues including senior team morale, loss of senior talent, and the potential to make a major mistake. Judging someone’s ability to operate at the CEO level is never a sure thing.

Many emotional and psychological obstacles impede CEO succession. By raising the CEO succession topic *early*, the board removes any concerns about when or if to raise it.

These concerns clearly make the point that there are many emotional and psychological obstacles that impede CEO succession. These obstacles are rarely acknowledged or publicly discussed. However, there are some practical and realistic steps that boards can take to avoid these problems. The emerging best practices below can help sidestep the powerful emotional hurdles to CEO succession.

The topic of CEO succession should always be open for discussion. To collectively lower sensi-

Succeeding At Succession

Elements Of A Good Succession Plan

The specific aspects of a good succession plan vary from company to company based on a host of variables. These include: capabilities of internal successor(s); CEO retirement timeline; and the company’s relative strength (or weakness) in the market.

There are some “best practices” we have seen across companies. Three of the most important parts of a good CEO succession plan include:

Viable internal candidates. The current CEO and board members have a reasonable confidence that there are internal executives who have the requisite management experience, leadership and other interpersonal capabilities, company and industry knowledge, and executive presence. Does the company have concerns that the candidate could be successfully recruited away, or would be successful in another company as a CEO? If those two conditions are operating, chances are you have a viable candidate.

An active development plan for the candidate exists. This has several moving parts. The board should assure that the candidate has been formally assessed, ideally by both internal and external sources. Is he or she viewed positively against a range of criteria including operating excellence, P&L experience, self-awareness, 360-feedback received and acted on, financial skills, and has respect within the company? Not only has the candidate been assessed against these criteria, but there is a clear understanding about their strengths and weaknesses relative to becoming the next CEO.

The “active” part means the board is sure that something is being done to better prepare and position the candidate. At a tactical level, this is the CEO’s responsibility but they frequently engage other resources, including consultants and coaches. Even more important, they also take an active hand in preparing the candidate. Other developmental preparation can include external training, coaching, and increasing awareness of the candidate to the financial community, other directors, large shareholders, and important customers/suppliers.

The board is up to date on the candidate, the plan, and progress being made. The board (or the CEO succession oversight committee) is knowledgeable on the candidates, their development plans, and the activities underway to prepare the candidate to become the CEO.

tivity about CEO succession planning for both the board and for the CEO, one of the first topics to be addressed upon the appointment of a new CEO is identifying potential replacements. This discussion should engender no more emotion than scheduling an audit or reviewing a business unit.

The lead director or appropriate board committee chair should introduce the topic immediately, and, working collaboratively with the new CEO, begin the process of laying out how internal candidates will be chosen and groomed. Having just gone through the process, the CEO and board will both be fresh in how it worked, what needs to be changed, and how to further streamline it. In addition, everyone is up to speed on the depth of the bench of new CEO candidates, and likely has an opinion.

While it may be premature to set a future timeline, this discussion makes it clear to the incoming CEO that one of his/her responsibilities is preparing a successor. Also, by raising the topic the board has removed any concerns about when or if to raise it. By taking a traditional “undiscussible” and putting it on the table at the beginning of the CEOs’ tenure, the board sidesteps concerns about undermining the CEO’s confidence by making it part of their ongoing agenda.

□ *The board should be involved in senior level succession planning.* The board should become deeply involved in all levels of the company’s top succession, including the details. We are not suggesting a detailed audit of human resources. However, the board should be aware at all times who is in the talent pipeline and what is being done to develop them.

A leading Midwestern manufacturing company scheduled annual talent reviews, led by the head of HR, where the top 15 positions (and their possible back-ups) were reviewed. Objective data were collected including an outside psychological assessment, and an internal 360-degree survey.

Senior executives made periodic strategic presentations to the board on either their function or business. These presentations were done in executive committee where the top insiders including CEO, CFO, and chairmen were excused from the meeting.

In this way, the board was kept informed, allowed to ask penetrating questions, and could size up the talent pipeline.

Human resource reviews, with an annual presentation by the CEO to the board on their top talent and potential successors, are not a bad thing. However, they are inadequate to meet the ever changing demands and dynamic nature of senior leadership needs. Worse, these limited reviews reinforce the “feel good” climate that permeates board meetings around talent development. The board waits for their annual update to be told what they want to hear—all is well.

If all is truly well, why are so many corporations dealing with CEO misfires and failures? The board should always know the potential CEO successors and also know what management is doing to insure their growth. The board’s role is to provide oversight and act as a counter-balance to internal dynamics.

When it comes to the timing and frequency of succession discussions, “it depends” is probably the most accurate answer.

Human resources frequently does an excellent job of senior executive succession planning. However, they know that preparing and planning for the CEO role is sacred turf, and can only be blessed and supported by the CEO. It takes a very secure and confident HR executive to raise the succession issue with the CEO—particularly if that CEO does not want to talk about it.

As to the timing and frequency of these discussions, “it depends” is probably the most accurate answer. Every CEO succession is different since every company differs in their succession needs, their board composition, their timing horizon, talent available both internally and externally, etc.

As a rule of thumb, an in-depth and thorough review of CEO succession annually is probably sufficient early in the CEO’s tenure. When the CEO’s planned retirement date is within several years, or the company is declining, it may be wise to hold this review twice a year.

□ *Stress test the CEO succession plan.* Many boards have adopted “what if” contingency planning for special and once-in-a-lifetime circumstances and developed action plans to prepare. Some boards periodically “stress test” their contingency plans to insure that they have a plan, timetable, and assigned responsibilities to deal with potential disaster. Similarly, stress testing the CEO succession plan on a periodic basis is a good idea.

For example, every several years a major professional services company assembles their compensation committee prior to the board meeting for a close-in review of CEO succession. The committee meets with the CEO and the head of HR to review their senior level succession planning, probe departure candidates (either through dissatisfaction or competitor offers) and looks skeptically at their existing replacement plans.

Over time this mini-review has exposed several flaws in their succession reasoning, requiring revisions to retention and pay practices. A small group that closely examines the “seams” of current practice and is encouraged by the CEO to find weaknesses will often find things that escaped the review of the entire board.

□ *Succession planning should be part of the company’s DNA.* This suggestion relates directly to company culture, and is based on the premise that strong CEO succession planning is anchored in strong succession planning throughout the organization. A number of Fortune 500 companies have traditionally had strong reputations for their dedication to succession planning including CEO succession—General Electric, PepsiCo, Walgreens, United Technologies, and Kimberly-Clark. They have imbued their cultures and their managers with the responsibility for

selecting, grooming, and testing managerial talent.

Working collaboratively with an empowered HR function, these cultures support frequent talent reviews, job changes to challenge and grow capabilities, and training and development exercises which foster leadership self-awareness.

Of course, strong succession planning cultures are not created overnight. Most of the companies historically named to the lists of “best companies” for developing leaders have focused on this for over 25 years. The board should view ongoing stewardship responsibility for succession planning at all levels as part of managements’ (particularly senior management’s) role. The expectation is always there that senior management will devote a reasonable amount of their valuable time recruiting, coaching, providing feedback, and growing the next generation of leaders.

A board would never let a CEO remain ignorant of their competitors’ activities, strategies, and pricing, or avoid working with the senior team on strategic plans. In a similar vein, the informed board should not let the CEO ignore succession planning.

CEO succession is not a rifle shot, once-a-year discussion about the CEO’s replacement. It represents the culmination of succession and development activities integrated well down in the organization. It ensures that 30- and 40-something executives are receiving developmental assignments, have development plans and are given opportunities to hone their leadership skills.

The board needs to insure that this takes place. By concentrating on only the top job, and assuming that meaningful succession planning is taking place further down in the company erodes long-term corporate viability. ■

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